

April 15, 2015

Hon. John Thune
Co-Chair, Business Income Tax
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Benjamin Cardin
Co-Chair, Business Income Tax
Committee on Finance
United States Senate
219 Dirksen Senate Office Building
Washington, DC 20510

Dear Senators Thune and Cardin:

The Research & Development (R&D) Alternative Simplified Credit (ASC) Coalition - whose members cover the full spectrum of U.S. manufacturers including those in the aerospace, automotive, construction, farming, defense, pharmaceutical, computer chip, software, and other high-technology industries – writes to encourage that any tax reform legislation include a robust and permanent incentive for research and development conducted in the United States.

The R&D Tax Credit Creates and Supports U.S. Manufacturing Jobs

The purpose of the R&D tax credit is to encourage investment in U.S.-based research and to promote high-paying jobs here in the United States. The R&D credit has done both – particularly in the manufacturing sector.

- Manufacturers in the United States perform more than three quarters of all private-sector R&D in the U.S. (Bureau of Economic Analysis, National Economic Accounts by Industry, 2013.)
- Between 70% and 80% of the R&D tax credit is directly attributable to the salaries of U.S. workers performing research in the United States.
- According to the National Science Foundation, average wages in the science and technology occupations are 1.8 times (or nearly 80% higher) than the average wages for all occupations.
- Several studies including a recent study by the Center for American Progress and the Obama administration’s *Framework for Business Tax Reform* conclude that, “the credit is effective in the sense that each dollar of foregone tax revenue causes businesses to invest at least an additional dollar in R&D.”
- A 2014 study by TechAmerica found that U.S. firms invest an additional \$94 in research and development for every \$6 the federal government invests through the R&D tax credit.

- In national defense, the R&D credit ensures the United States maintains a qualitative national security edge in aerospace and other important defense industries. A 2012 CRS study found that “...the U.S. commitment to military R&D has contributed to a favorable balance of trade in the defense and aerospace industries.”

United States Pioneered the First R&D Tax Credit

In 1981, the United States became the first country to provide an R&D incentive through the tax code. The enactment of this incentive helped establish the United States as a leader in cutting-edge research, spurred robust R&D investment in the United States and helped drive economic growth through the 1980s and 1990s. Congress designed the R&D credit to be an important incentive in spurring private sector investment in innovative research by companies of all sizes and in a variety of industries. Unfortunately, the United States is no longer the innovator when it comes to R&D incentives. Today the United States ranks just 22nd out of 30 countries that provide R&D tax incentives. (Organization for Economic Co-operation and Development, December 2013.)

The United States Needs an Enhanced and Permanent R&D Credit to be Competitive

In the global economy, companies have a choice as to where they invest in research and development. With most countries offering both lower tax rates and more robust R&D incentives, the United States needs to provide competitive tax rates and globally competitive R&D incentives that can be counted on (i.e. permanent) or risk losing valuable U.S. research investment and the associated U.S. jobs. U.S. companies don't need to travel across the globe for lower rates and more robust R&D incentives – our neighbors Canada and Mexico offer both.

Meanwhile, global pressures on U.S. innovation continue to grow beyond NAFTA economies. Only half a decade ago, the U.S., Canada and Mexico accounted for nearly 40 percent of global R&D. Today that share has dropped to 34 percent, with the U.S. shrinking from 34 to 31 percent. While at the same time Asia's share of R&D investments has grown from 33 percent to nearly 40 percent. In addition, China's total R&D investments have grown to more than 60 percent of those of the U.S. (The Information Technology & Innovation Foundation – February 2015)

The ASC Should be Increased and Made Permanent

The one thing that the President and many House and Senate Republicans and Democrats have all agreed on is that the Alternative Simplified R&D tax credit (ASC) should be increased and made permanent.

- In recent years, the President's Budget has called for a permanent ASC increased from 14 percent to 17 percent.

- *The American Research and Competitiveness Act of 2015* (H.R. 880) introduced by Representatives Brady (R-TX) and John Larson (D-CT) calls for a permanent ASC increased from 14 percent to 20 percent. A similar bill passed the House in 2014 by a vote of 274 to 131 with 62 House Democrats supporting the bill.
- In the past Chairman Hatch, along with a group of bipartisan members of the Finance Committee, introduced a bill to make the R&D ASC permanent at 20 percent. Most recently, the Finance Committee demonstrated bipartisan support for a two-year extension of the R&D ASC in the *Expiring Provisions Improvement, Reform, and Efficiency Act of 2014* (S. 2260).

Under current law, there are two R&D tax credits: the “traditional” R&D credit and the ASC. The “traditional” R&D credit is tied to a business’s research expenditures and gross receipts in the 1984 through 1988 time period. The ASC is tied to a business’s research expenditures over the more-timely most recent three year time-period.

Congress enacted the ASC in 2006 to respond to the fact that a significant number of businesses (despite investing large amounts on research and development) were getting little or no benefit from the “traditional” credit. Today, at a 14 percent rate, the ASC is the R&D credit utilized by the vast majority of businesses that conduct research and development. Virtually all businesses investing in research and development would utilize the ASC over the “traditional” credit if the ASC was increased from 14 percent to 20 percent.

More importantly, increasing and making permanent the ASC would significantly increase U.S. job growth and the U.S. GDP. According to the 2010 Information Technology & Information Foundation Study, increasing the ASC from 14 percent to 20 percent would add 162,000 U.S. jobs in the high-tech sector alone and increase GDP by \$66 billion annually.

The bottom line is that in order to attract and to maintain research and development in the United States, we need a competitive tax code that offers both a lower tax rate and a strong permanent R&D incentive. Our businesses desperately want to keep and to expand their U.S. research and development in the United States but they cannot ignore the significantly lower tax rates and strong R&D incentives that are being pushed on them by other countries on almost a daily basis.

Simplify Administration of the R&D Tax Credit

As discussed in great detail in the GAO’s November 2009 Report, *The Research Tax Credit’s Design and Administration Can Be Improved*, the overall effectiveness of the R&D tax credit is currently reduced by the significant administrative compliance burden.

One way to address this issue is to provide more clear and concise definitions and examples of what activities qualify for the R&D tax credit. Reducing the subjectivity as to what qualifies as a “new” or “improved” product would enable taxpayers to better comply with and to avoid expensive controversies with the IRS.

One particular area of concern is the IRS disallowing certain qualified research expenditures on the basis that they are performed after the beginning of commercial production. As noted in the GAO Report, “[practitioners] objected to Treasury deeming certain activities, such as preproduction planning, tooling, trial production runs, and debugging flaw, to occur after commencement of production when they often actually occur before the manufacturing process is ready for commercial use.” Providing better definitions and examples in this area would both reduce controversies and make the credit more effective.

We thank the Finance Committee and the Business Working Group for the opportunity to provide input on the importance of a robust U.S. R&D tax incentive. As you work through the tax reform process, please do not hesitate to contact us.